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EXPORT RESTRAINTS AND THE DEVELOPING COUNTRIES

Study prepared by

Tracy Murray*

* Tracy Murray is the Philipps Petroleum Company Distinguished Professor of International Economics and Business at the University of Arkansas USA.

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I. INTRODUCTION

1. Protectionism has been growing gradually with bilateral export restraints playing an increasingly important role in the total picture. The number of export restraints grew from about 50 in 1978 to 263 in 1989. These protective policies are introduced mainly by developed countries (primarily the European Community and the United States) and are applied mainly against the developing countries. For example, in 1989 the exports of developing countries were restrained by 153 export restraint agreements while 49 VERS affected exports of the developed market-economy countries.

2. Why has this trend occurred? One hypothesis is that it is the result of an evolution of co-operation between government and industry with the catalyst for action shifting from government to industry. A second hypothesis is that the trend is the result of a pro-trade bias in the political economy of protectionism: fear of a legislative response to protectionist pressure from constituents induces a free-trade oriented executive branch to pre-empt legislative action by introducing more flexible types of protectionism, including export restraints. The first hypothesis leads to the conclusion that this trend will continue and that international trade will become increasingly regulated by ever tighter export restraint arrangements. In contrast, the second hypothesis leads to the conclusion that protection via export restraints is a "least worse" among competing bad alternatives; in the final analysis the protection that is introduced is designed to minimize the adverse effects, i.e., it will be "porous."

3. Whatever the motive underlying the use of export restraint arrangements, the trend is unmistakable. The plan of this paper is as follows. Section II will describe the alternative forms of export restraint arrangements. Their economic effects will be analyzed in section III. Section IV discusses the political motivations underlying their increasing popularity. The quantitative significance of export restraints on trade is presented in section V; Section VI emphasizes the effects on developing countries. Finally, section VII presents policy concerns and recommendations.

II. ALTERNATIVE FORMS OF EXPORT RESTRAINT ARRANGEMENTS

4. An export restraint is an arrangement between an importing country and an exporting country whereby the exporting country limits its exports of a particular product or category of products to the importing country. The form of the arrangement has several variations including "orderly marketing arrangements" (OMAs), "voluntary export restraints" (VERs), or "voluntary restraint arrangements" (VRAs).

5. The major element in all export restraint arrangements is that the limitation on trade between the countries is imposed by the exporting country at the "invitation" of the importing country. A secondary element is that the arrangement is inherently discriminatory. The arrangement is typically bilateral, with exports to other countries permitted without restriction; it is possible, however, for a country to have export restraint arrangements covering a particular product sector with several countries.

6. The primary distinction between alternative forms of export restraints involves the formality of government involvement. At one extreme, the arrangement between the two Governments would consist of an informal "understanding" with the actual export restraint being administered by a non-government entity. The guidelines for the administration of the export restraint might be communicated to the non-government entity in the form of a public statement by the Government regarding its expectation that exports of the product will not exceed a particular level. It is also possible for the exporting country's Government to take an active role in the industry negotiations to set particular export volumes for each producer or exporter yet claim that the export restraint arrangement involves non-government administration. Generally OMAs are informal

export restraint arrangements.¹

7. At the other extreme are export restraint arrangements that involve formal government administration. Exports might be regulated through the issuance of export licenses by the exporting country and imports might be closely monitored by the importing country. The restraint levels could be rigid or involve consultation provisions that are triggered as the actual level of trade approaches the restraint level. There are also export restraint arrangements that include carry-overs from one period to the next, from one product category to another, or from one restrained exporting country to another. Such flexibility reduces the restrictiveness of the export restraint arrangement but obviously means more formal involvement of Governments in the administration of trade. VERs and VRAs generally include more formal government involvement in the export restraint programme. At the extreme the importing country may have customs regulations in force to assure that actual imports do not exceed the restraint levels.

8. In this paper the term "voluntary export restraint" (VER) will be used to designate an export restraint arrangement without regard to the nature or extent of government involvement. The term will apply equally to OMAs, VERs and VRAs.

III. ECONOMIC EFFECTS OF VERs

9. The economic effects of trade restrictions are well known. In the importing country import prices increase and import volumes decrease. The higher import prices benefit competing domestic producers but harm consumers. Moreover, consumers lose more than producers gain; consumers lose owing to higher prices on both imported and domestic goods whereas producers gain only from higher prices on domestic production. In the exporting country export volume and prices to third countries both decline. In this case, consumers gain and producers lose. But since producers lose owing to lower prices on all of their production (whether exported or sold domestically) and consumers gain only from lower prices on domestic output sold at home, producers lose more than consumers gain. In both countries the net economic interests of producers and consumers are negative.

10. Trade restrictions also create a price wedge between what consumers in the importing country are willing to pay and what exporters are willing to accept. Who captures the revenue associated with this price wedge depends upon how the trade restriction is administered. If the restriction is administered by the importing country, then the Government or importers capture this revenue. For example, if a tariff is used the Government collects revenue. If import quotas are given to importers the importers capture the price wedge as monopoly rents. If import quotas are auctioned by the Government, the Government realizes revenue. On the other hand, if the trade restriction is administered by the exporting country then the revenue associated with the price wedge accrues to the exporting country.

11. The economic effects of a VER depend upon a number of factors including the restrictiveness of the restraint levels, the flexibility of administration of the restraints, and the presence of unrestrained third country suppliers. At one extreme, if the export restraint level exceeds the market clearing level of trade, the restraint is not binding and its economic effects are zero. In this case the issue is moot. Generally, however, the restraint level are binding. In this case, exports from the restraining country would be lower in volume and higher in price than would occur if the VER did not exist. If the VER were subject to flexible administration, the volume and price of exports would be intermediate between the binding and not binding cases. The economic effects would be in the same direction; however, the magnitudes would be smaller.

12. The presence of unrestrained suppliers that compete with the restrained exporters would also moderate the magnitude of the volume and prices effects. In essence, trade diversion occurs. Exports from the restrained country would be diverted to third countries; and exports from unrestrained suppliers would be diverted from third country markets to the importing country that

¹ Under United States law, the negotiation of an OMA is one of the permitted options available to the President to grant escape clause relief to U.S. industry pursuant to Article XIX of the GATT.

imposed the VER. A detailed analysis of VERs and trade diversion is presented in the annex below. In order to limit the extent to which trade diversion moderates the effects of VERs, the VER importing country must expand the coverage of the VER to all major suppliers of the product. The VER exporting countries would experience reduced export volumes; however, the total value of those exports might increase depending upon the magnitude of the quota rents captured on their reduced volumes of exports to the VER importing country.

13. The direct effects of VERs are to divert trade from the VER importing country to the rest of the world and to divert income (i.e., the quota rents) from consumers in the VER importing country to producers in the VER exporting country. We now turn to four additional indirect effects.

14. The first deals with quality upgrading. The administration of export restraints requires precise definitions of the products covered by the arrangements. Normally, the products subject to export restraint will be heterogeneous categories that include similar though different items. Exporters that are limited by VERs have an incentive to alter the items exported to increase the total revenue earned. This is achieved by reducing the share of low unit value items that are exported and increasing the share of high unit value items. This effect is the so-called quality upgrading effect.²

15. For example, the U.S.-Japan automobile VER covers vehicles produced by several different Japanese companies. The automobiles included range from small standardized vehicles to larger vehicles loaded with options. When the VER was first introduced, US imports from Japan were dominated by small low-priced vehicles whereas today US imports are predominantly larger, up-scale vehicles.

16. The second indirect effect of a VER is the substitution of direct investment for trade. It is often suggested that the recent trend by Japanese automobile companies of building automobile assembly plants in the United States is a direct response to the U.S.-Japan automobile VER. There are others who argue that such investment would have occurred in the absence of the VER owing to higher assembly costs in Japan. Regardless of which view is true, the VER does create an incentive for the restrained supplier to serve the controlled market through production in other countries, including the controlled country. Thus, the restrained supplier does have an incentive to invest in productive capacity abroad -- either in the controlled country or another unrestrained country.³

17. The third indirect effect involves downstream producers who use the VER product as an input in their production process. This indirect effect, however, is not unique to VERs; it is equally applicable to any trade restriction. In the simplest analyses, the VER importing country would experience an increase in the price of the restrained input, thereby increasing costs to those domestic firms that use the imported input. These firms would become less competitive *vis à vis* imports of the downstream product; they would lose sales at home and in their export markets. Costs for restrained and third country producers of competing downstream products would decline owing to the decrease in the world price of the input. These producers would gain market share at the expense of producers in the VER importing country.

18. To illustrate, the United States has protected the steel industry for roughly two decades. It is to be expected that steel-using firms in the United States would have increasing difficulty competing with imports from those countries that restrain exports of steel; this has occurred in such product sectors as automobiles, fork-lift trucks, heavy construction machinery, etc. This is not to say that in the absence of protection all steel-using industries would have performed satisfactorily; obviously, particular industrial sectors may experience a multitude of economic difficulties, including the downstream effects of policies designed to assist the domestic steel industry.

² For example, see Robert C. Feenstra, "Quality Change Under Trade Restraints in Japanese Autos," *Quarterly Journal of Economics*, February 1988, pp 131-146 and B.Y. Aw and M.J. Roberts, "Measuring Quality change in Quota Constrained Import Markets: The Case of U.S. Footwear," *Journal of International Economics*, August 1985, pp 45-60.

³ A similar investment pattern is occurring in the Caribbean Basin. Apparel exporting countries in Asia, whose exports to the United States are severely limited by VRS under the GATT multifibre arrangement, are investing in sewing plants in the Caribbean region.

19. A final economic effect of VERs concerns emerging suppliers. When a VER is first imposed by an importing country it typically only limits trade from the major supplier. This restriction provides an opportunity for emerging suppliers to expand their exports to the VER importing country. Those emerging countries that are best able to take advantage of this opportunity are likely to face a VER in the future. Thus, there are two sides to evaluating the effects of the VER on emerging suppliers: (1) the benefit of the initial market opportunity, and (2) the disadvantage of the subsequent VER that limits exports. Whether the VER programme provides a net benefit or disadvantage to emerging suppliers depends on whether the emerging suppliers would have been successful in penetrating the market in the presence of unrestrained competition from the major exporting countries.

IV. POLITICAL ECONOMY OF EXPORT RESTRAINTS

20. The political economy of export restraints deals with three primary questions: (1) Are VERs consistent with GATT obligations? (2) Why do importing country Governments prefer VERs to alternative measures that limit imports? and (3) Why do exporting country Governments agree to restrain exports?

21. The first question is easily answered in the negative if one is concerned only with the spirit of the GATT. VERs obviously discriminate among source of supply and therefore are inconsistent with the spirit of Article I -- the most-favored-nation principle of non-discrimination. However, if one reads the GATT more critically and concludes that it is a document of procedures rather than a document of rules, a different answer might result. This is especially true if the GATT is considered to be a set of procedures for the resolution of conflicts between trading partners.

22. Under a VER, the exporting country restrains exports to a particular importing country. If the importing country does not complain, what role does GATT have in resolving the (non) dispute? While there are multilateral implication, e.g., third country producers often suffer the consequences of the VER, how is such an issue brought to GATT? Does an injured third country Government bring a complaint under Article XXIII (i.e., nullification or impairment of benefits under the GATT) against the VER importing country -- that does not restrict imports? If so, the country would have to demonstrate the loss of a benefit under the GATT, which might be quite difficult; moreover, such action might identify the country as a potential source of imports from unrestrained suppliers thereby "inviting" a VER against their exporters.⁴ Suffice it to say that there have been few GATT challenges to VERs initiated by third countries.

23. The main GATT prohibition against export restrictions is contained in Article XI which is a general prohibition against all measure that restrict trade. Article XI states, in part,

"No prohibitions or restrictions other than duties, taxes or other charges, whether ... through quotas, import or export licenses or other measures, shall be instituted or maintained ... on the importation ... or ... exportation ... of any product ..."

24. Exports were included to assure guaranteed access to the products of a trading partner. However, when the exporting country restrains exports at the invitation of the importing country, who is to bring action before GATT?

25. To summarize, VERs are not consistent with the spirit of GATT. Nevertheless, so long a GATT is essentially a procedures-based system to resolve conflicts, VERs will fall through the cracks of enforcement. We can only conclude that VERs are a "gray area" under the GATT.

26. In order to answer the second question one must know the alternatives available to the importing country Government. There are two primary justifications for a country to restrict imports under the GATT: escape clause action (Article XIX) and remedies to unfair trade practices, es-

⁴ This point, and other issues of GATT consistency, are discussed in J. Jackson, "Consistency of Export Restraint Arrangements with the GATT," *The World Economy*, December 1988.

pecially dumping (Article VI) and subsidies (Article XVI). The escape clause entitles a country to temporarily restrict imports if those imports cause material injury to the competing domestic industry. However, import restrictions introduced under the escape clause entitlement are to be non-discriminatory; moreover, trading partners adversely affected by the action are to be compensated.⁵ These two requirements (non-discrimination and compensation) make countries reluctant to utilize the escape clause. The non-discrimination requirement poses a problem if imports from only one or two suppliers are the source of injury to domestic industry; governments are disinclined to restrict imports from other countries thereby undermining political relations with these countries. Moreover, it is often difficult to pay effective compensation; the economic value of reciprocal concessions may have been eroded by other agreements negotiated since the concession to be withdrawn was put in force. If it is instead decided to directly compensate those countries most adversely affected by the escape clause action, the importing country may find it has little of value to offer, especially given the low average level of tariffs and the fact that the remaining high tariffs involve import-sensitive products.

27. If escape clause action seems problematic, using antidumping or antisubsidy (i.e., countervailing duty) provisions of the GATT to protect a domestic industry is equally unattractive. First, these provisions refer to remedies against unfair imports. In order to introduce trade restrictions under these provisions the importing country Government, in effect, must indict the trading partner for trading unfairly. Furthermore, the requirements for introducing antidumping and countervailing duties are quite rigorous and legalistic. This, in turn, means that once an unfair trade remedy is introduced it becomes very difficult to terminate. Conversely, VERs are negotiated under discretionary authorities granted by legislative bodies to the executive branches of Governments. Likewise, they can be terminated under these same discretionary authorities. It is true that, once introduced, VERs are often considered by the protected domestic industry to be property rights; any steps to terminate VERs often become the source of intense political pressure. Nevertheless, the incidence of VERs being terminated is much greater than that for antidumping or countervailing duties.

28. Thus, Governments facing domestic political pressure to introduce protectionist policies to assist specific domestic firms are reluctant to use GATT sanctioned measures. But at the same time, if the political pressure is strong enough the executive branch of government may not be able to resist. If the executive refuses to accede to the interests of the domestic industry, the legislative branch of government may require such action through legislative enactment. Executive fear of legislative action is a powerful inducement for the executive to find an alternative solution. First, legislative action may result in a more protectionist measure than would result from executive action and, thereby, accentuate the political problems with those trading partners. Second, legislative action is often permanent and can be reversed only by new legislative action, whereas executive action is generally discretionary and can easily be reversed following a reduction in political pressure or by counter political pressure. In general, the Executive prefers action pursuant to discretionary authority granted by the legislative branch of government. Export restraint arrangements are typically negotiated under the discretionary powers of the Executive.⁶

29. Thus, it is not difficult to understand why the Government of the importing country prefers export restraint arrangements to GATT sanctioned alternatives. We now turn to the third question: Why does the exporting country agree to restrain exports? Three possible answers to this question follow. First, the exporting country may appreciate the political pressures facing the importing country government. The exporting country may conclude that restrictions on imports into the trading partner must be introduced, either consistent with or in violation of GATT rules; the domestic pressure facing the importing country government is too strong for international obligations to prevent protection. The exporting country Government, considering protectionism as a foregone conclusion, negotiates with the objective of minimizing the adverse effects of the

⁵ In its purest form the escape clause entitles a country to withdraw an earlier concession granted on a particular product provided causal linkages can be established between the initial concession, the increase in imports, and material injury to the domestic industry. Thus, compensation is to be paid to the country that initially granted the reciprocal concession. Because of the time lag between the initial concession and the withdrawal, it is possible that the country entitled to compensation is no longer the country most adversely affected by the escape clause action.

⁶ It has also been suggested that export restraints arrangements are often intended by the executive to be ineffective, i.e., export restraints are a porous type of protection; see J. Bhagwati, *Protectionism*, (Cambridge, Massachusetts: MIT Press, 1988).

protectionism that will be introduced. Very simply, the negotiation of a VER is a cost minimizing strategy.⁷ To the extent that the resulting VER is more liberal or more likely to be reversed in the future than the alternative protective measures, export restraint is a wise policy for the exporting country.

30. A second motive for the exporting country to consent to a VER would exist whenever the quota rent earned from the VER exceeds the injury caused by the reduction in export volumes. In this regard it is important to recognize that the injury resulting from a VER would be quite small if alternative markets for the restrained product exist. If alternative markets exist, the potential injury facing the country agreeing to restrain exports is transferred to producers in other countries.

31. A third motive involves the political economy within the exporting country itself. The administration of an export restraint requires the exporting country to allocate shares of the importing country market to particular firms in the exporting country. This, in fact, creates and assigns property rights for these markets to established firms. Moreover, it often relieves these firms from having to compete with their most intense competitors -- other firms in the exporting country. In such cases, individual firms in the exporting country would be pressuring their own Government actively to seek co-operation in the form of a VER. Those firms in the exporting country with the most to lose from the export restraint, the rapidly growing emerging suppliers, might be too small at the present time to carry much weight during the government's negotiations with the importing country government.

V. QUANTITATIVE SIGNIFICANCE OF VERS

32. Table 1 presents data on VERs by product sector. The EEC (10) or its members States and the United States alone account for 87 per cent of the agreements (excluding agreements in the textile and clothing sector); the other developed countries use VERS almost exclusively to limit imports of agricultural products and textiles and apparel not covered by the MFA.

33. Apart from agreements in the textile and clothing sector, the EEC agreements range widely across product sectors. The developing exporters most seriously affected by VERS imposed by the EEC include Brazil, Republic of Korea and Venezuela on steel products, Republic of Korea and Taiwan Province of China on footwear, Republic of Korea on electronic products and Argentina, Brazil, Chile, Thailand, Uruguay and Yugoslavia on agricultural products. In contrast, the US agreements are heavily concentrated in steel products. Other major VERS of the United States affect beef imports from Australia and New Zealand, automobiles from Japan,⁸ and machine tools from Europe, Japan and certain Asian NICs. The developing countries most seriously affected by the VERS on steel products include Argentina, Brazil, Republic of Korea, Mexico, Trinidad and Tobago, Venezuela and Yugoslavia.

34. The use of VERs grew dramatically during the 1980s, the United States alone accounting for the major portion of the trade affected by this kind of measure. The import coverage ratios of VERS by the EEC grew from 6.2 per cent in 1981 to 7.8 per cent for 1989 and those of the United States grew from 13.8 per cent in 1981 to 15.5 per cent in 1989 (see table 2).

35. The major contribution to the growth in VERs of the United States is the President's policy

⁷ It has also been suggested that antidumping proceedings have been used to coerce trading partners to accept export restraint arrangements. See, for example, Hindley and J. Bhagwati, "Export-restraint Arrangements and the 'Unfair Trade' Connection," paper presented at the Trade Policy Research Centre conference entitled Political Economy of Export-restraint Arrangements, Washington, D.C., June 1989.

⁸ This is a truly voluntary export restraint as the Government of the United States has announced publicly that it has terminated its request that the Government of Japan restrain exports to the United States.

Table 1

NUMBER OF VERS IN FORCE IN 1989, BY SECTOR IN THE DEVELOPED
MARKET-ECONOMY COUNTRIES.

PRODUCT SECTOR	EEC(10)		USA	CND	OTHER ^a DEVELOPED	TOTAL
	ALL	NATIONAL				
Agricultural Products	23	2	2	-	8	35
Textile Products	32	-	43	28	52	155
Footwear	-	4	-	1	1	6
Iron and steel	12	-	25	-	-	37
Machine tools	1	-	2	-	-	3
Vehicles and parts	3	4	1	1	-	9
Electronics	6	2	3	-	-	7
Others	2	1	1	3	-	7
TOTAL (excluding textile products)	47	13	34	5	9	108
TOTAL	79	13	77	33	61	263

Source: UNCTAD Trade Control Measures Information System.

^a Austria, Denmark, Finland, Japan, Norway, Sweden and Switzerland.

to assure the domestic steel industry that imports will not capture more than 18.5 per cent of the domestic market. This policy, which began in 1984, resulted in the negotiation of numerous VEs with countries in Europe (including Eastern Europe), Asia, Latin America, and Australia, Canada and South Africa. The future of this policy is uncertain. In July of 1989 Ms. Carla Hills, the United States Trade Representative, announced that the administration would request enforcement authority for a two-year extension and phase-out of the United States VE programme for the steel sector.⁹ However, this request is accompanied by a commitment from the administration to call for an international agreement to eliminate unfair trade practices in the steel sector. It is unclear whether the phase-out is conditional upon the successful negotiation of such an agreement. Failure at this juncture effectively to phase-out the steel VE programme might result in the steel VEs becoming as ingrained in the trading environment as is the GATT multifibre arrangement.

36. For comparison purposes, exports by the developing countries to the EC and the United States are more seriously restrained by VEs under the MFA than by VEs on all other products combined. In 1989 11.2 per cent of EEC imports (excluding fuels) from the developing countries involved textiles and clothing products subject to VEs under the MFA whereas only 2.4 per cent of such imports involved other products subject to VEs. For the United States the two import coverage figures were 14.8 per cent for textiles and apparel VEs and 2.2 per cent for other VEs.

37. The analysis above draws inferences about the restrictive effects of VEs on the basis of trade flows in products subject to VEs. There are obvious biases from such inferences. If VE limits exceed actual trade flows, the VE is not binding and no adverse effects result even though the above analysis would count such a VE as restrictive. Conversely, using trade flows as an index of the importance of a VE underestimates the significance of the more restrictive VEs, e.g., an import embargo resulting in zero imports is not counted as restrictive when trade flows are

⁹ The original ERAs on steel are scheduled to expire in September 1989; the ERA programme has recently been extended through March 1992.

Table 2

Import coverage ratios ^a of VERs, by country groupings, applied
by selected developed market-economy countries ^b

(Percentages)

Importing Countries	IMPORTS FROM:							
	World		Developed Countries		Developing Countries		Socialist Countries	
	1981	1989	1981	1989	1981	1989	1981	1989
Austria	0.3	0.3	0.0	0.0	4.2	4.1	0.0	0.0
Canada	4.1	2.1	2.8	0.1	15.4	20.2	18.8	25.9
EEC (10)	6.2	7.8	2.8	4.6	11.9	13.6	13.5	13.5
Finland	0.3	0.4	0.1	0.1	3.5	4.5	0.0	0.0
Norway	0.1	0.7	0.1	0.1	0.0	8.0	0.0	5.8
USA	13.8	15.5	11.2	14.3	19.0	17.0	8.1	14.0
ALL SELECTED DMELCs	7.6	8.5	5.3	6.6	13.3	13.3	9.9	10.5

Source: UNCTAD Trade Control Measures Information System.

^a Ratios have been computed using 1986 import trade weights. Computations were made at the tariff-line level and results aggregated to relevant product group levels.

^b Austria, Canada, EEC (10), Finland, Japan, New Zealand, Norway, Switzerland and the United States.

Note: The accuracy of the NTM information has been verified by certain developed market-economy countries. The basic data are currently being verified by other countries. Accordingly the figures in the table are to be regarded as preliminary and subject to revision.

used as the indicator of the restrictive effects of a trade measure. In order to get an accurate picture of the significance of VERs one must conduct a detailed examination of each VER, noting in particular, the precise product categories covered, the restraint levels of each item in the product category, any provisions for flexible administration of the restraint levels, the source of imports subject to the VER, and the scope for trade diversion from unrestrained suppliers. Such an examination of United States VERs was recently completed by the United States International Trade Commission.¹⁰

38. This study includes an examination of all quantitative import restraints for which United States imports of affected products exceeded \$100 million during 1987. The products identified by this procedure are steel, automobiles from Japan, and machine tools. Since the major purpose of this study was to identify the benefits and costs to the United States economy of import restraints, little detail regarding the effects on exporting countries is reported. Nevertheless, some information can be gleaned from this study indicating the effects of the VERs on trading partners.

39. The VERs on steel were generally binding during 1985 and 1986. However, by 1987 many of the VER quotas for some major exporting countries and products were no longer binding, primarily owing to the dollar's depreciation and the rise in demand for steel worldwide. The USITC reports that imports accounted for 94 percent of the total export limits under the programme. On a global basis, VER ceilings were filled only for semi-finished steel and steel plates; VERs were not binding for other steel product categories. During 1988 the VERs were even less binding.

40. The United States has VERs covering machine tools with Japan and Taiwan Province of China that limit their shares of the U.S. market to 1981 or 1985 levels. The United States also informed Switzerland and the Federal Republic of Germany that their exports to the United States should not exceed similar levels. Taiwan Province of China overfilled all of its quota limits during

¹⁰ The Economic Effects of Significant U.S. Import Restraints, Phase I: Manufacturing, USITC Publication 2222, (Washington, D.C.: U.S. International Trade Commission, October 1989)

1987 and 1988 whereas Japan fell considerably short of all of its limits.

41. In early 1981, Japan announced that it would limit exports of automobiles to the United States to 1.68 million units during April 1981 through March 1982. This step was taken by the Government of Japan in response to the proposed United States legislation to restrict United States imports of cars from Japan to 1.6 million units. During the following two years this VER was renewed with the same export limits. Even though the United States Government did not request an extension beyond the third year, the Government of Japan has continued to limit automobile exports to the United States every year since, though at the higher level of 2.3 million units. Owing to the sharp increase in the value of the Yen and the increase in the assembly of Japanese automobiles in the United States, the USITC concludes that the export restraint limits are no longer a significant restraint. During 1987 the limits were 96 per cent filled; by 1988 the limits were only 94 per cent filled. Moreover, the historical pattern of imports (very high shipments during the first month of the quota year and very low shipments during the last month) changed in 1988 indicating that the export limits were not binding.

VI. EFFECTS OF VERS ON DEVELOPING COUNTRIES

42. In the vast majority of cases, VERs imposed against exports from developing countries involve textiles and apparel; these VERs are negotiated under the auspices of the GATT multibre arrangement. Generally it is the more advanced developing countries whose exports of other products are restrained by VERs. The restrained products are heavily concentrated in the steel sector; the United States imposes VERs against Argentina, Brazil, Republic of Korea, Mexico, Venezuela and Yugoslavia and the European Community imposes steel VERs against Brazil and Republic of Korea. In addition, the EC imposes VERs on footwear from the Republic of Korea and cassava from Thailand; the US imposes VERs on machine tools from Taiwan Province of China.

43. As a case study, information about the effects of VERs on developing countries can be gleaned from a recent study on the historical experience of Republic of Korea.¹¹ In 1987 29 per cent of Korean exports to industrial countries were subject to some type of non-tariff trade restrictions (27 per cent on exports to the United States and 40 per cent on exports to the European Community); roughly one-half of these exports involve textiles and apparel VERs under the MFA.

44. The experiences of Republic of Korea document that VERs tend to be contagious. The fear of trade diversion leads to a spread of VERs by importing countries in two directions. First, the VER importing country expands the countries subject to VERs to unrestrained exporters; e.g., after the United States imposed a VER on Japanese imports of color TV sets, Republic of Korea and Taiwan Province of China were likewise restricted. Second, other importing countries also impose VERs to prevent a diversion of exports from the restrained country, i.e., after the United States imposed a VER on Republic of Korea imports of footwear, the United Kingdom and Ireland imposed similar VERs.

45. While the incidence of VERs has increased dramatically during the 1980s, VERs are not permanent. One of the attractive features of VERs is that they are negotiated by the executive branches of Governments under discretionary authorities rather than as the result of legislative action. This means that VERs can be terminated by executive action as well; new legislative action is not required. Of the 20 VER agreements affecting Republic of Korea during the 1980s, eight have been terminated. The majority of terminated agreements were negotiated between Governments and included specific duration periods. In contrast, VERs initiated by industrial associations tend to constitute a much more permanent feature of the trading environment.

¹¹ T. Bark, "The History, Institutional Framework and Economic Consequences of VRS in Korea," paper presented at the Trade Policy Research Centre conference entitled Political Economy of Export Restraint Arrangements, Washington, D.C. June 1989.

46. Most of the Republic of Korea VER agreements contain flexibility provisions which allow the substitution of exports of one product category for another ("swing") and from one time period to another ("carry forward" and "carry back") with limits. These flexibility provision reduce the restrictiveness of the VERs; however, this does not mean that Republic of Korea exports of products covered by VERs are not severely restrained as a result.

47. Concern that VERs will cause trade diversion plays an important role in the negotiations of VERs. The Government of the Republic of Korea typically requests an "equity clause" in its VERs to guard against an erosions of the Republic of Korea's market share by increased imports from other major exporting countries. While such equity clauses are not always included, the intent is to have the VER importing country expand its VER programme to include other competitive exporters.¹²

48. Moreover, the Government of the Republic of Korea is aware that the adverse effects of a VER imposed by one country can be moderated by diverting Republic of Korean exports to third country markets. In other words, the greater the country diversification of its exports, the smaller will be the adverse effects of a new VER being imposed. This possibility plays a central role in the Republic of Korea Government's administration of exports subject to VERs. The Government of the Republic of Korea uses a two-tier system to allocation exports; the system includes a "basic quota" and an "open quota." The "basic quota" for each exporter is based on last year's export volumes to the restricted market and accounts for roughly 80 per cent of the total quota. The remaining "open quotas" are allocated on the basis of several criteria including (1) last year's average unit export value (an incentive for quality up- grading), (2) last year's export volume to other countries (an incentive to diversify exports by market), and (3) last year's export volume of other products (an incentive to diversity exports by products). This export allocation system clearly contains two objectives: the first is to protect the vested interests of the major exporting firms in the restricted market and the second is to diversify and up-grade exports, thereby, protecting the value of export earnings and reducing future vulnerability to VERs.

49. A recent study on the effects of steel VERs imposed by the United States and the European Community presents estimates of the price and volume effects of the VERs on restrained exporters and domestic producers in the US and the EC.¹³ The average unit price of steel imported into the US and EC from restrained suppliers increased by about \$20 per metric ton; the volume of US and EC imports from the restrained suppliers declined by an estimated 3.5 million metric tons, 1 million of which was from developing countries. As a result of trade diversion the restrained exporters experienced declines in their total sales volumes by less than 1 per cent. In terms of sales revenues, however, it was estimated that restrained countries captured \$450 million in quota rents from the higher prices in the restrained markets, roughly \$130 million of the quota rents accrued to developing countries. In value terms, the gains in quota rents far exceeded the losses from lower sales volumes.

50. In return domestic producers in the United States and the European Community benefitted from higher prices of \$0.38 per ton; their sales increased by 1 million tons. Thus, the major effect of the steel VERs was to transfer income to the restrained exporters with minimal benefits accruing to domestic producers.

¹² Interestingly, such a policy works to the disadvantage of Korea. As the analysis in the Annex demonstrates, the greater the share of the market supplied by unrestrained exporters, the greater the opportunity for Korea to divert its exports to third countries, thereby, decreasing the adverse effect on Korea's total exports.

¹³ See D. Tarr, "Effects of Restraints on Steel Exports of Korea and the Rest of the World," paper presented at the Trade Policy Research Centre conference entitled Political Economy of Export-Restraint Arrangements, Washington, D.C., June 1989.

VII. POLICY CONCERNS AND RECOMMENDATIONS

51. Why should developing countries be concerned about VERs? History is the answer. The GATT MFA programme began in the late 1950s as a temporary measure to give U.S. producers time to adjust to increasing import competition from Japan. The programme was first formalized in the one-year Short-Term Arrangement Regarding International Trade in Cotton Textiles of 1961, which begat the Long Term Arrangement of 1962, which was renewed and extended and expanded to become the Multifibre Arrangement of 1974, and so on to the present day. Thus, it has grown into a quagmire that literally allocates access to developed-country markets to the advantage of developed-country producers. Those countries whose exports to the United States market benefit include Canada and Italy (unrestrained countries) while countries with demonstrated international comparative advantage (the developing countries and especially those in Asia) are closed out of any growth in the market.

52. The steel VER programme is still in its infancy, but has all the indications of a programme that will be renewed and extended and expanded for a long time to come -- even though the current administration in Washington, D.C., has publically announced its intention to terminate the programme by March of 1992. It is a programme to protect the economic interests of established producers in the United States and Europe, regardless of their international competitiveness. The prospects for emerging suppliers of steel products in world markets are very dim.

53. From the perspective of a political economist, one might judge VERs as an attractive alternative compared with other forms of protection. After all, there are many VERs that have been terminated. Nevertheless, once introduced VERs create property rights to markets. These property rights become the motive for intense political pressure exerted by industry on government.

54. And we must not forget that even though the major VERs cover textile and steel products, there are numerous VERs limiting trade in less significant sectors including footwear, cutlery, machine tools, color TVs, videotape recorders, radios, microwave ovens, meat, dairy products and fish. While this list is not endless and it is not aimed specifically at developing countries, our concern is its tendency to grow.

55. Historically, VERs have been most commonly applied to trade in mature products. As the pattern of international comparative advantage changes, new productive capacity is created in emerging supplier countries without a phase-out of productive capacity in those countries that are losing their international competitiveness. As a result excess capacity develops to the detriment of established producers. The major VERs of today involve mature industries -- textiles and steel. However, there are a few "minor" VERs that pertain to more dynamic sectors like consumer electronics. The early application of VERs can lock out emerging suppliers. Thus, if a country is not participating at the very early stage in the development of a new industry, it will not be able to break-in at a later date.

56. International markets are being increasingly closed to the more competitive emerging exporters. And the techniques to close markets increasingly fall into the "gray" area of international discipline. The VER is a primary example. How can the international community moderate this trend?

57. Transparency: The first step is to create an international agency to record all measures that restrict or limit access to any country's market. The UNCTAD data base on nontariff measures is a good start. Countries that negotiate VERs should be obligated to provide copies of all agreements, including the products covered and the administrative details, to the data base for dissemination to all member Governments and private entities in all member countries.

58. Transparency has two important contributions to make. Recognizing that trade diversion is a likely outcome of a VER, other producing and consumer countries will be concerned about the effects of a VER on their markets. If they are aware of the VER their concerns can be communicated to the VER importing and exporting countries. Sufficient expressions of concerns from trading partners can provide a significant voice against excesses in the use VERs.

59. The second major effect of a VER is to raise prices in the VER importing country. This imposes costs on consumers, which if informed, can provide a counter lobby against the intro-

duction of a VER.

60. Multilateral participation: In general, VERs are the result of bilateral negotiations between powerful importing countries and weaker trading partners whose national economic well-being is importantly dependent upon export markets.¹⁴ This disproportionate power puts the VER exporting countries at a negotiating disadvantage. Multilateralism provides a support group for those countries negotiating from the weaker position.¹⁵ Moreover, multilateralism often requires some countries which would rather not be involved to take a position. This can become the source of pressure for the initiating country to drop the case. And finally, multilateral issues tend to be newsworthy to the embarrassment of the initiating country's Government.

61. VERs must not be permanent: The GATT escape clause provides for temporary and declining protection to assist the adjustment of an import-competing industry that is no longer competitive. At the very least, international rules should include finite duration periods, declining levels of protection to promote the phase-in of open markets, and obligations on the protected industry to undertake adjustments sufficient to compete in open markets.

62. International monitoring and dissemination of information: International trade and domestic production in products subject to VERs should be monitored. Periodic economic impact studies should be conducted for each VER and the results disseminated to all countries -- Governments and private entities, including the press.

¹⁴ Major exceptions are the steel VERS imposed by the United States on imports from member states of the European Community. However, the steel VERS essentially constitute an international cartelization of world trade in steel which is considered to be in the best interests of the EC.

¹⁵ Interestingly, Hong Kong refuses to negotiate VERS other than those governed by the GATT sanctioned multifibre arrangement.

ANNEX

VERs AND TRADE DIVERSION

63. The VLR is a discriminatory trade restraint; it restrains exports to one country but not to others. Consequently, exporters restrained by VLRs have an incentive to divert exports from the restrained market to third country markets. Such trade diversion increases the competition in third country markets which, in turn, gives third country producers an incentive to divert trade to the VLR imposing country.

64. To better understand these relationships, let us identify three countries -- the home country that requested the VLR (H), the country that agrees to restrain exports (R), and unrestrained third country exporters (U). First, consider the case in which the product being supplied by the three countries is homogeneous (and subject to zero transport and trading costs). Thus, the law of one price prevails, i.e., purchasers will always select the lowest price supplier which yields a single price equilibrium. In this case, a VLR has no economic effect other than to divert trade. Any tendency of the restraint to increase the price of R's exports to H would attract an increase in imports from U thereby depressing the price. Likewise, the export restraint would increase the supply of exports from R to third countries depressing prices there. This would further induce U to divert exports from third countries to H thereby offsetting the price depressing effect of the diversion of R's exports to third countries. In the final equilibrium, the single world price would be determined by world supply and world demand -- which are not altered by the VLR. And thus, the VLR would have no economic effects other than to alter the market shares of each of the three suppliers in world markets.

65. The homogeneous product case is extreme; this case is unlikely to occur in the real world. First, international trade generally involves positive transport and trading costs that differ by source of supply. Second, product quality differs by supplier. And third, conditions of trade differ, e.g., delivery time, quality control, credit terms, buy-back arrangements, after-sales services, etc. Thus, it is more reasonable to analyze the economic effects of a VLR under the assumption that the product is differentiated by source of supply. In this case there are three world markets, one for the product of each supplier. These three markets, however, must be analyzed jointly since the products supplied by H, R and U are substitutable. That is to say, the demand for the output of each supplier depends on the prices of the product from the other suppliers.

66. Figure 1 depicts the demand and supply for R's product (hereafter product R). S_r and D_r are, respectively, the supply of product R to the world and the world demand for product R. D_{rh} is the demand by country H for imports of product R; the horizontal distance between D_r and D_{rh} is the demand for product R by the rest of the world including consumers in country R (D_{row}).

67. In the absence of a VLR, the equilibrium price and quantity are P_r and Q_r , respectively, with Q_{rh} being imported by country H. When the VLR is imposed by country H on imports from country R (at the level Q_{era}) the price of those imports increases to P_r' thereby constraining the demand by country H. This in turn reduces the world demand for product R; for prices below P_r' the world demand is equal to Q_{era} plus that of the rest of the world, i.e., D_r . The new equilibrium price and quantity for product R in the world market are P_r'' and Q_{rw}' , respectively.

68. There are two opposing effects of the VLR on country R. On the positive side, quota rents accrue to exporters in R equal to the price wedge ($P_r'' - P_r'$) times the volume of exports under the VLR (Q_{era}). On the other hand, the diversion of exports from H to the rest of the world depresses the price of those exports to P_r'' . The volume of exports to the rest of the world will increase but not by as much as the volume of exports to country H decreases; there will be a net decline in the volume of product R that is sold on world markets, including country H and country R. Whether country R gains or loses from the VLR depends upon the size of the quota rents relative to the losses from a lower price and volume of sales to the rest of the world.

69. Figures 2 and 3 depict the world market for the competing products of countries H and U, respectively. The impact of the VLR on these two products is similar. The demands for products H and U by country H (D_{hh} and D_{hu} , respectively) increase because of the VLR induced increase in the price of R in country H; the demands for products H and U by the rest of the world (D_{hrow} and D_{urrow} , respectively) decrease because of the diversion of exports of product R from H to the rest of the world. The net effect of these demand shifts is uncertain; however, it is most likely that the total demand for H and U combined increases by roughly the decrease in production of product R.

70. Consider first the effect of the VLR on sales of the competing products in country H. The VLR will increase the demand for H and U combined by an amount roughly equivalent to the decrease in country H imports of product R. If the three products are equally substitutable for each other, then sales of H and U in country H will each increase in proportion to their market shares. If the net benefits of the VLR to domestic producers in country H are insufficient, those benefits can be increased by subjecting additional countries to VLRs, i.e., transfer countries from group U to R. If the VLR programme is expanded to include all major suppliers of the product category to H, the group of unrestrained suppliers will account for a very small share of the market. Thus, domestic producers will capture the lion's share of the benefits to be derived from the VLR.

71. Next consider the effects of the VLR on sales of the competing products to the rest of the world, including the domestic market in country R. These sales will be displaced by sales of product R that is diverted from country H. If domestic producers in country H also export, they would share the loss of markets with the unrestrained producers. However, if domestic producers in country H are truly not able to compete in world markets, their exports would be quite

small. Thus, the unrestrained producers will incur the losses resulting from the diversion of country R's exports from country H to the rest of the world.

72. To summarize, the most likely scenario would involve the negotiation of a VER by an importing country that exports very little; over time the VER programme would be expanded to include all major suppliers thereby limiting the producers that benefit from the VER to domestic producers. The remaining unrestrained producers would be net losers owing to the diversion of country R's exports from country H to the rest of the world. The countries that restrain exports would experience reduced export volumes; however, the total value of those exports might increase depending upon the magnitude of the quota rents captured on their reduced volumes of exports to country H.

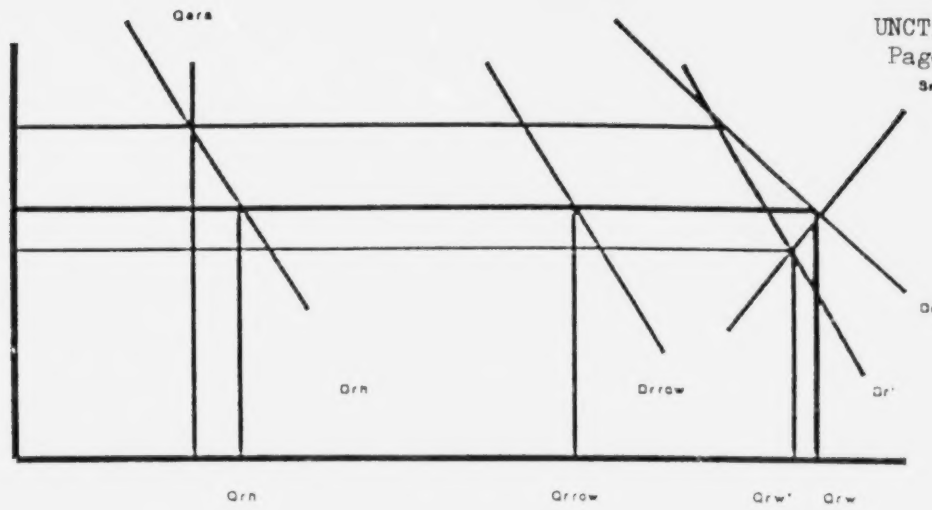


Figure 1. World Market for Product R

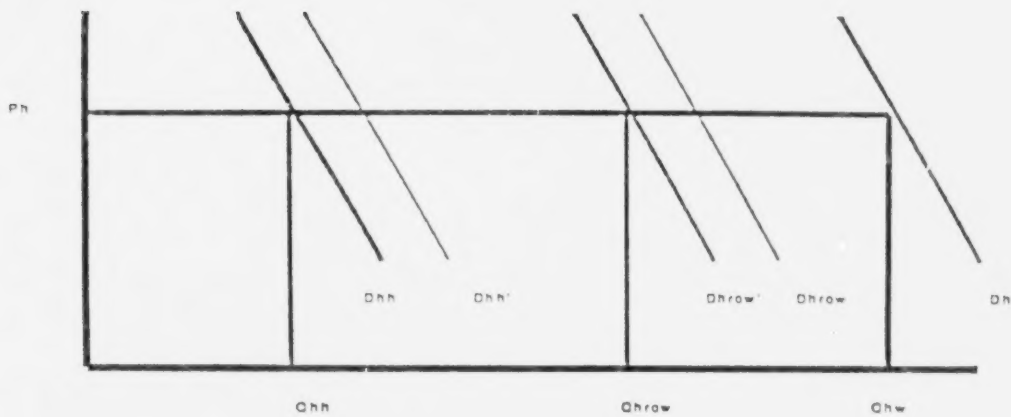


Figure 2. World Market for Product H

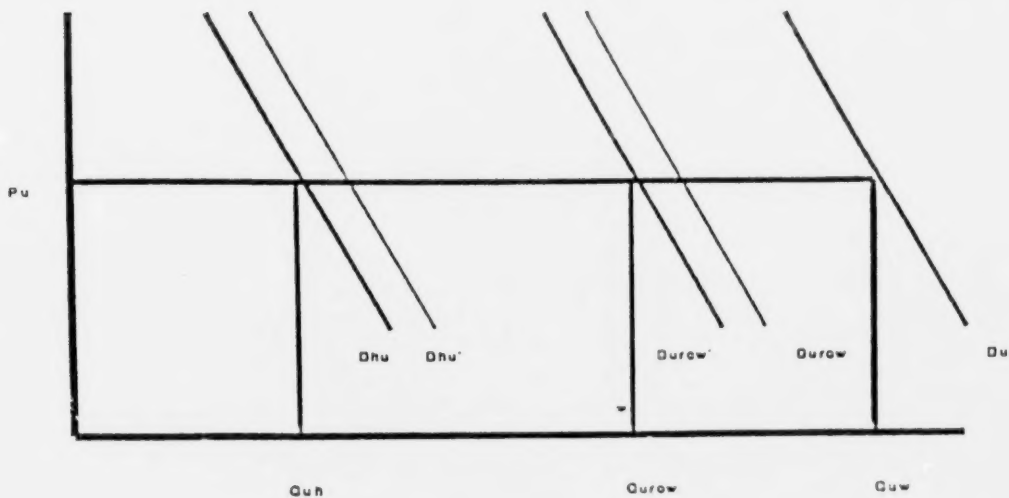


Figure 3. World Market for Product U